The Outlook for Asian & Australian Economies

Stable growth will continue backed by solid domestic demand and an expansion of export to advanced countries

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1. Overview of Asian and Australian Economies

Real GDP growth of China, the largest economy in Asia, stood at +6.8% YoY in Oct-Dec 2017, remaining the same level as the previous quarter (see table1). Fixed asset investment as a whole decreased as an increased infrastructure investment could not make up for a decline in investment to heavy industry which was a result of reduction in excess production capacity and tightening environmental regulation. Meanwhile private consumption remained firm and export accelerated backed by global economic expansion.

Looking at other Asian economies excluding China, strong export is boosting the pace of growth in addition to solid domestic demand, particularly that in private consumption. Real GDP growth in Oct-Dec 2017 slightly accelerated in Taiwan, Indonesia and Vietnam, and largely maintained stable level in other economies as well (see table1).

Table 1: Real GDP Growth Rates, Major Asian Economies

(YoY, %)

	2016			2017			
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
China	6.7	6.7	6.8	6.9	6.9	6.8	6.8
India	8.1	7.6	6.8	6.1	5.7	6.5	7.2
South Korea	3.4	2.6	2.4	2.9	2.7	3.8	3.0
Taiwan	1.0	2.0	2.8	2.6	2.3	3.2	3.3
Hong Kong	1.8	2.2	3.3	4.3	3.9	3.7	3.4
Singapore	1.9	1.2	3.7	2.5	2.8	5.5	3.6
NIEs	**2.5**	**2.3**	**2.7**	**3.0**	**2.8**	**3.9**	**3.2**
Indonesia	5.2	5.0	4.9	5.0	5.0	5.1	5.2
Malaysia	4.0	4.3	4.5	5.6	5.8	6.2	5.9
Thailand	3.6	3.1	3.0	3.4	3.9	4.3	4.0
Philippines	7.1	7.1	6.6	6.4	6.7	7.0	6.6
Vietnam	5.8	6.6	6.7	5.2	6.3	7.5	7.7
ASEAN5	**5.0**	**5.0**	**4.9**	**5.0**	**5.3**	**5.6**	**5.5**
Asia 11 economies	**6.1**	**6.0**	**6.0**	**6.0**	**6.0**	**6.2**	**6.2**
Australia	**3.3**	**2.1**	**2.5**	**1.9**	**2.0**	**2.9**	**2.4**

Note: Shadowed portion indicates lower growth rates from previous quarters.
Source: Individual country statistics, BTMU

Looking ahead, Asian economies as a whole will maintain stable growth in 2018 as domestic demand, particularly that in private consumption will remain solid and export is expected to expand.

China will face with an unavoidable economic slowdown as Xi administration in its second term will focus on addressing corporate debt problem which is expected to weigh on investments. Though tightening monetary policy to some extent is expected in order to curve mounting corporate debts, the authority will implement fine-tuned policy management so as to avoid the financial market turmoil such as interest rates spike and liquidity shortage, and significant slowdown in real economy. Also backed by the ongoing upward trend in export and firm expansion of private consumption, real GDP growth is expected to maintain mid +6% YoY range in full year of 2018.

In other Asian economies, domestic demand, particularly that in private consumption will remain solid owing to the ongoing monetary and fiscal supports to stimulate the economy as well as stable employment and income environment. Export will maintain its moderate upward trend backed by growing demand from advanced countries though the pace of expansion will decelerate compared to last year. Real GDP growth in 2018 is expected to remain upper +2% YoY range in NIEs as a whole and upper +5% YoY range in ASEAN-5 respectively. Indian economy is expected to return to stable growth path led by domestic demand as the effect of Goods and Services Tax (GST) introduced in July 2017 settled and the government's economic-stimulus package supported the economy. Australian economy is expected to maintain its recovery trend mainly due to an expansion of capital investment amid accommodative monetary policy.

Foreseeable risk could be a destabilization of financial markets owing to move towards the monetary policy normalization in advanced countries such as US and the escalation of geopolitical risks. Major Asian currencies in general have remained stable recently supported by factors such as an expansion of capital inflow from overseas on the back of favorable fundamentals, however weaker movements have been continuously observed in countries with current account deficit such as Indonesia and Philippines. Although most of the central banks have maintained an accommodative monetary policy as prices remained stable and low, the risks of massive fund outflow and sharp depreciation of currencies remain as the continuous rate hikes are expected in US. Sharper than anticipated decline in domestic currency often leads to an increase in inflation, makes it difficult to maintain an accommodative monetary policy, and could hinder firm private consumption and business activities.

2. Outlook of each country and region

(1) Chinese Economy

Xi Jinping, who cemented the foundation of his administration for a second term at the Communist Party Congress last year, will focus on structural adjustment even further eyeing mid-to-long term development. In addition to the ongoing effort to reduce excess production capacity, the government has been working on curving soaring corporate debts which is expected to weigh further on investments. However, the authority is expected to implement fine-tuned policy management so as to avoid the financial market turmoil and significant slowdown in real economy. Also backed by the ongoing upward trend in export and firm expansion of private consumption, real GDP growth is expected to reach mid +6% YoY range in full year of 2018.

We will look at the details below. Reduction in production capacity in 2017 has reached the annual target in all three sectors of steel (50 million ton), coal (150 million ton) and coal-fueled generation (50 million kW). An effort to reduce production capacity of steel and coal will continue in 2018 in order to reach the mid-term target which was set in February 2016, and the move towards deleverage will also be a headwind against investments. The monetary authority has introduced measures to tighten regulations on shadow banking and online banking since

November 2017 as well as raising money market rates since early 2017 (see chart 1). Infrastructure investment, which has been a principal driving force of investments, will inevitably slow down as the central government has become more cautious about mounting debts held by local governments and state-owned enterprises. Private investment has already shown a sign of slowdown since late 2017 due to monetary tightening.

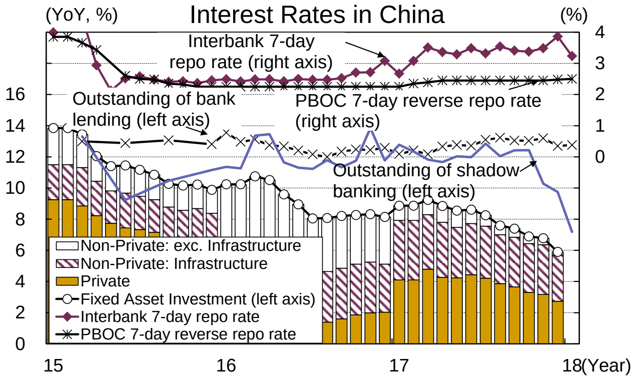
Real estate investment has also been affected by a sluggish growth in housing sales. In major cities where the housing prices have soared, both price and sales growth slowed down as a result of reintroduction and tightening of regulations by local governments since the autumn of 2016. This has shifted investment demand to small and medium cities, however selling restrictions prevailed there as well due to price increase.

Nevertheless, downturn in investment is expected to be avoided owing to policy supports in broad areas. The monetary authority is aiming to increase flow of funds by lowering reserve requirement ratio (RRR) for limited banks and limited periods starting from 2018 (1. RMB 450 billion of long-term liquidity through banks whose loans to small enterprises satisfy certain conditions , 2. RMB 2 trillion of temporary liquidity through large and medium-size banks around Lunar New Year holiday), also paying careful attention to avert turmoil in the financial markets due to soaring interest rates and liquidity shortage. The government has also indicated that it would continue to implement the policy to cut corporate costs, following last year. A complete cool down in real estate investment is unlikely to happen as some local governments started to relax rules on home purchase, together with a decline in home inventory (35% below its peak level) and solid actual demand.

Meanwhile, private consumption will remain firm supported by the favorable employment and income environment with stable income growth both in cities and rural areas and with high job-to-applicants ratio, together with a positive effect of new trends where internet companies are focusing on stimulating demand for goods and services by using information and communications technology (ICT). Tax cut on small cars which was introduced in October 2015 expired at the end of 2017 after the tapered tax cut in early 2017, however a decline in motor vehicle sales in reaction to the expiration is unlikely as no prominent rush demand for motor vehicle purchase was observed at the end of 2017.

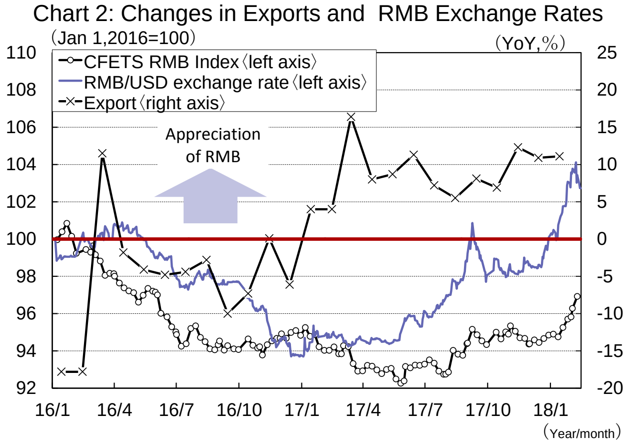
Looking at domestic demand, sufficient room for policy response will limit possibility of slowdown. On the other hand, it is undeniable that there are contingent risks with export. Although an acceleration of economic growth in US in response to the large tax cut will support the upward trend in export (see chart 2), it could be a major disturbing factor if trade friction against US is intensified even further. While the strict protectionist measures which had been initially concerned were not implemented during 2017, export to US recorded a strong figure of + 11.5% YoY and trade surplus with US slightly expanded which is frustrating US government further. Attention needs to be paid to the yuan's exchange rate against the US dollar which is currently trading near the highest level since the devaluation in August 2015, in addition to the hard-line trade policy against China by Trump administration.

Chart 1:Fixed Asset Investment, Outstanding Loans and Interest Rates in China



Note: 1. "Fixed asset investment" is cumulative YTD based on the amount publicly announced.
2. "Outstanding of shadow banking" is a total of "entrusted loans", "trust loans", "bank acceptance" and "corporate bonds".
Source: National Bureau of Statistics of China, BTMU Economic Research Office

Chart 2: Changes in Exports and RMB Exchange Rates



Note:The export data for the months of January and February is calculated based on a total export volume in those two months to correct for statistical distortions arising from Chinese New Year.
Source: China Foreign Exchange Trade System (CFETS), General Administration of Customs of the People's Republic of China, BTMU Economic Research Office

(2) Other Asian Economies

Asian economies excluding China will maintain stable growth supported by ongoing growth-friendly fiscal policy and accommodative monetary policy associated with stability in the value of currency, in addition to export expansion and the favorable effect of it, amid solid domestic demand. The governments in the region have already been implementing fiscal management which focus on lower-income group, employment and infrastructure investment, and they are also expected to implement growth-friendly policies on the political front considering that there will be important elections lined up in the region: Malaysia (by June: general election) and South Korea (June: local elections) in 2018, Thailand (around February: general election), Indonesia (April: presidential election) and India (April: Lok Sabha general elections) in 2019.

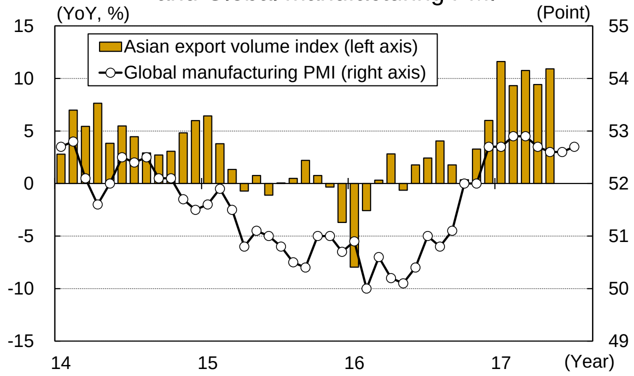
Export will slow down its pace of growth towards the second half of 2018 as the cycle of demand for semiconductors is expected to pass its peak, however its increasing trend will be maintained backed by growing demand from advanced countries, etc. (see chart 3). An increase in export will make a direct contribution to growth and will also help to boost growth rate through ripple effect to other expenditures such as an expansion of private investment as a result of an improvement in corporate earnings and an expansion of private consumption associated with an increase in household income.

[Thailand]

Thai economy remains solid. Real GDP growth came in at +4.0% YoY in Oct-Dec 2017, maintaining higher growth in recent years (see chart 4). Private consumption remained firm, and export of goods and services also expanded firmly which supported the growth. Looking at private consumption, there has been a clear sign of recovery in motor vehicle sales as the effect of the government's "First-car buyer" incentive program (implemented from September 2011 till the end of 2012 on the condition of resale prohibition for five years) has come to an end. Looking at the number of visitor arrivals, the one from China turned towards a recovery after having remained stagnant due to crackdown on the illegal tour companies.

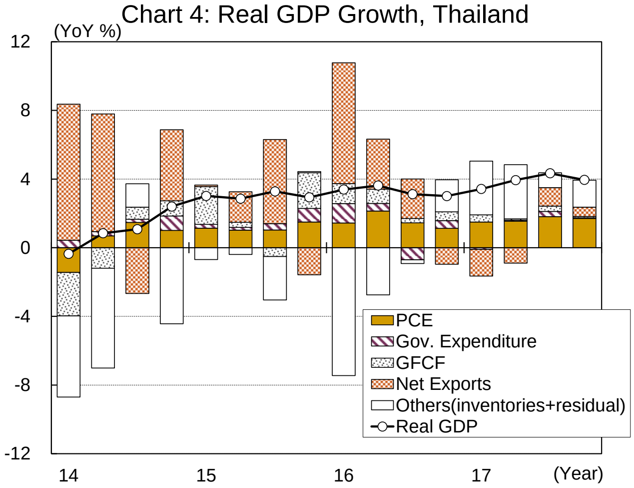
Going forward, an improvement in corporate earnings as a result of export expansion will make a positive contribution to private consumption through an increase in employment and income and the economy will continue to grow moderately. The government approved the infrastructure investment project (of total THB 1 trillion) on expansion of international airports, construction of high-speed railways between major airports, and port maintenance in Eastern Economic Corridor (EEC) in the three Eastern provinces in early February, the relevant legislation was approved by National Legislative Assembly (NLA), and the acceleration of investment by the implementation of the project will support the economic expansion.

Chart 3: Asian export volume index and Global manufacturing PMI



Note: "Export volume" are the YoY growth rate of the volume of exports from S. Korea, Taiwan, Singapore, Malaysia, Thailand weighted average by total export value of respective country in 2016. 3-month moving average.
Source: Each country's national statistics, BTMU Economic Research Office

Chart 4: Real GDP Growth, Thailand



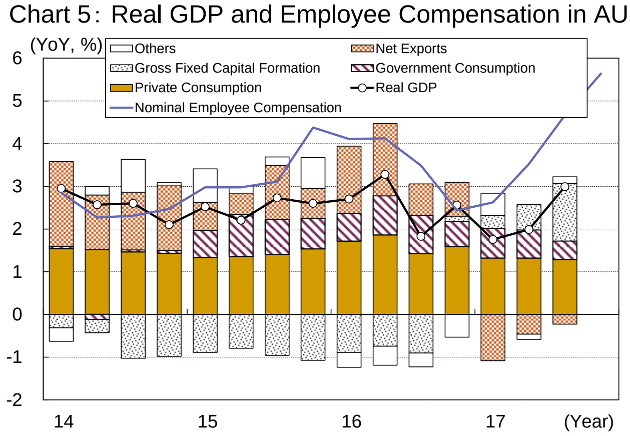
Source: NESDB, BTMU Economic Research Office

(3) Australian Economy

Australian economy continues to recover moderately. Private consumption has remained firm supported by an improvement in employment and income environment as well as continued low interest rates (see chart 5). Looking at gross fixed capital formation, a recovery in capital investment continued particularly in private non-mining sector and an expansion of infrastructure investment by the government also contributed to boost the growth rate.

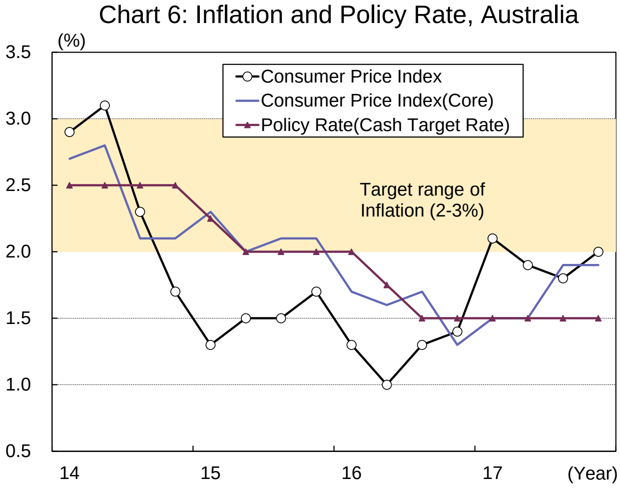
Going forward, an expansion of global economy will drive an increase in export and an expansion of capital investment through an improvement in international commodity markets and corporate earnings amid gradual recovery of private consumption, and the recovery trend of economy will be maintained. Looking at price and monetary policy, Consumer Price Index (CPI) recorded +1.9% YoY in Oct-Dec 2017, below the inflation targeted range (+2-3% YoY) (see chart 6). Considering that the wage growth remains moderate, policy rate will stay lower level and support the economy.

Chart 5: Real GDP and Employee Compensation in AU



Note: "Nominal Employee Compensation" is calculated based on the number of employees and wage growth per week
Source: Australian Bureau of Statistics, BTMU Economic Research Office

Chart 6: Inflation and Policy Rate, Australia



Source: ABS, RBA, BTMU Economic Research Office

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